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Supplementary Actions

to the

1975 Ontario Budget



The Honourable W. Darcy McKeough
Treasurer of Ontario

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*Ont. Ministry of Treasury, Economics and
Intergovernmental Affairs. Taxation and Fiscal
Policy Branch.*

Supplementary Actions

to the

1975 Ontario Budget



Presented by the Honourable W. Darcy McKeough,
Treasurer of Ontario
in the Legislative Assembly of Ontario,
Monday, July 7, 1975

Ministry of Treasury, Economics and
Intergovernmental Affairs
Fiscal Policy Division



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Supplementary Actions to the 1975 Ontario Budget

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**Appendix : Details of Retail Sales Tax Rebate on
Automobile Purchases**



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MR. SPEAKER

No Member of this Legislature can be unaware of the fact that on June 23 the Government of Canada tabled a budget--a surprising document, a document irrelevant to the needs of Canada and Ontario--a document that increases the tax burden on our citizens--that fuels inflation--that is mischievous in terms of the clear interests of the people and the provinces.

The critical fact is that it has the capability of stalling the recovery of our economy in the second half of this year. It has made it necessary for us to reinforce the forward economic thrust of the Ontario budget of April 7.

The Ontario budget of April 7 was selective. It was selective in terms of time, it was selective in terms of the points of impact in our economy. It was specific to the needs in lagging sectors, to the special needs of people, to the slowing of inflation, to the expansion of job opportunities in Ontario.

It was designed to have its major impact in the last half of 1975, to accelerate recovery during this period, to taper off in terms of its impact as the economy gained strength.

It was specific to the defined requirements of the economy. It was specific to sectors that particularly required stimulation or help--the automotive industry, construction of needed homes, reinforcing incomes and purchasing power of people, strengthening small business and farming, increasing investment and productivity, demonstrating the leadership of the Government of Ontario in the matter of expenditure restraint.

It was carefully planned to strengthen the Ontario economy and assist the people of the province in a period of excessive inflation and growing unemployment.

It was gravely undercut by the June 23 budget of the Government of Canada.

The price of energy was raised - \$740 million in a full year, a 10 cent levy was placed on every gallon of gasoline, inflation was escalated, the rate of job creation was slowed, costs to consumers were increased.

It called for new action by Ontario to compensate for its wrong direction and its gross inadequacies.

I was instructed by the Premier of Ontario to reassess the prospects of the people and the economy of Ontario in the light of this federal budget--a budget clearly adverse to the interests of Ontario and, indeed, of Canada.

In response, I am tabling two papers today as part of this Statement. One of these deals with Ontario's experience under federal-provincial cost sharing. As I see it, this is the most serious long-term aspect of the federal budget. The federal government imposed abrupt and arbitrary ceilings on its financial support of national medicare. It also announced the termination of cost-sharing arrangements for hospital insurance in the future. The Ontario paper clearly illustrates the degree to which Ottawa has used its fiscal surpluses to lever provinces into expensive sharing arrangements against their declared priorities. The federal budget is one more case where provinces are left to carry on with reduced federal support. I foresee that, under this new regime, Ontario and other provinces will be severely strained to maintain existing standards of health care. I suggest, therefore, an early meeting of Ministers of Health to consider the implications of the federal budget on the future of essential health services.

Further, on behalf of the Ontario Government, I now offer to assume complete responsibility for health care in Ontario. The Ontario Government, in so doing, will assume all future financial risks in exchange for 17 points of the personal income tax. Furthermore, Ontario is serving notice that it cannot afford and does not intend to enter into any new spending areas the federal government chooses to introduce as shared-cost programs.

The other paper accompanying this Statement is entitled, The Energy Factor and Ontario's Economic Recovery. This paper reviews the impact of the June federal budget on the prospects for Ontario's economic recovery. My Statement today is our response.

NEW ONTARIO INITIATIVES

Mr. Speaker, my 1975 budget plan called for \$430 million in fiscal actions to reinforce consumer spending, increase investment and productivity, and expand housing. Having fully committed Ontario's resources we anticipated that relevant policies by the federal government would assist economic recovery in 1975. The federal budget, however, has flattened emergent economic growth, negatively altered expectations and significantly reduced the resources available to the Province. I estimate that the fall-off in revenues will amount to \$100 million in 1975-76. In spite of the fact that our income is reduced, Ontario must now shoulder a grossly unfair proportion of the responsibility for economic stimulation and public sector control. Ontario must increase its initiatives in housing to reinforce this vital sector and compensate for the shocking inadequacy of the federal commitment.

We are determined to meet these additional needs and to compensate for the federal failure to ensure a healthy economic upturn. We are determined to achieve this purpose without increasing total government spending and without adding to inflationary pressures. The revised budget plan which I am tabling today, therefore, provides \$178 million for expansion initiatives to be financed by a reordering of our priorities and by cutting internal government expenditures.

EXPANSIONARY INITIATIVES

Additional Support to Housing

The Government of Ontario accorded the highest priority to housing programs in my April budget. Total funding in this vital area was increased to \$526 million.

Our package of housing initiatives included:

- . \$1,500 grants to new home buyers;
- . \$87 million for senior citizen and socially-assisted housing units;
- . \$43 million for the Ontario Housing Action Program;
- . \$41 million for the HOME program;
- . \$208 million for the Ontario Mortgage Corporation.

We reduced the sales tax on building materials, eliminated the sales tax on machinery used in construction and increased our capital investment in sewer and water facilities to service new and growing communities.

We expected our actions to be matched by a parallel federal commitment. In fact, the federal budget provided \$200 million in additional funds for housing for all of Canada. It did little to reduce mortgage rates or to stimulate mortgage funds. Given this federal failure, Ontario will act to ensure a supply of reasonably priced homes for the people of Ontario.

The Government will increase housing supply in four ways.

Senior Citizen Units

Ontario cannot and will not tolerate the inadequate funding in this area. To ensure that our target of 10,600 senior citizen and socially-assisted starts is met, Ontario will provide 100 per cent financing for 4,000 units. This will cost an additional \$80 million of which \$25 million will be spent this year, and \$55 million next year.

Accelerated Family Rental Program

My colleague the Minister of Housing has announced a commitment of \$90 million for new rental housing under the accelerated family rental program. Under this limited-dividend program, rents and rates of return are controlled for a minimum 15 years in return for an 8 per cent mortgage. We propose an additional \$50 million commitment to generate 2,000 new starts by the end of this fiscal year.

In conjunction with this new direct provincial lending commitment, we will undertake a complementary initiative - an interest subsidy program to private lenders who invest in limited-dividend rental projects before December 31, 1975.

These measures are targeted to produce an additional 6,000 rental starts for moderate and low-income families and involve \$50 million of provincial direct investment plus \$52.5 million of incentive subsidies over the 15 year term of the program.

Extended OHAP Program

To complement these actions, the subsidized OHAP rate of 10-1/4% will be extended to an additional 9,000 low-cost ownership units. One of the major difficulties in producing reasonably priced housing for moderate income families is the cost of mortgage financing. Effective today, interest subsidies will be applied for a five-year period to mortgages on all moderate income OHAP units started before March 31, 1976.

Private financing commitments of \$360 million will be required before December 31, 1975 if this target is to be realized. We are tabling today a paper which analyses trends in mortgage financing in Canada. It shows that the principal lending institutions have an impressive record in providing financing for housing. However, an even stronger commitment is required. Therefore, we have set up a series of meetings with the lending institutions to outline what this Government is doing and what we expect of them. The Premier, the Minister of Housing and myself will start these discussions by meeting with the chartered banks later today.

Additional Investment in Water and Sewer Projects

My original budget significantly increased our funding of water and sewer projects to \$138 million in 1975-76. I now propose an additional \$10 million in this essential housing support investment.

In addition the Province's 15% subsidy to local government systems will be increased by \$2 million to meet anticipated demand.

Ontario has enormously expanded its commitment and its funding to the housing sector. The actions I have outlined cover an additional 19,000 housing units which the Province will finance directly or assist in financing via incentives to private lenders. This will require additional provincial spending of some \$30 million this year, an additional spending commitment approaching \$100 million in 1976-77 and a total commitment in excess of \$200 million over the full term of these new programs. I had expected that 90,000 new housing units would be started in Ontario in 1975. Given the performance and events since my April budget, we are unlikely to exceed 75,000 starts this year. However, our new measures should ensure 90,000 starts in fiscal 1975-76. With these measures, Ontario will have done all in its power to ensure a resurgence in housing activity.

SUMMARY OF NEW HOUSING MEASURES				
	Additional Housing Units	Financing Requirements 1975-76	1976-77	Full Term Commitment
		 (\$ millions).....		
<u>Senior Citizen</u>	4,000	25	55	80
<u>Accelerated Rental</u>				
Direct	2,000	5	35	50
Subsidy	4,000	-	-	53
<u>Expanded OHAP</u>	<u>9,000</u>	<u>-</u>	<u>4</u>	<u>22</u>
TOTAL	19,000	30	94	205

Other Spending Initiatives

In addition to the major new actions in housing, the Government proposes a package of selective measures to assist other sectors of the economy. Student living allowances will be increased from \$32 to \$40 per week for the upcoming academic year. We are allocating an additional \$5 million for the repair and maintenance of university and college buildings in areas of high unemployment. To further help job creation directly, we are proceeding with five essential new government buildings in Windsor, Kitchener, Timmins, Dryden and New Liskeard. These capital projects, which involve construction costs of some \$20 million, will be built and financed by the private sector on a leaseback basis in order to minimize the burden on our 1975-76 finances.

In recognition of severe financing pressures on local governments we have provided an additional \$6.4 million. We have provided an additional \$6 million to the Ontario Transportation Development Corporation for research on new modes of transportation. To assist beef producers, we have introduced a cow-calf income stabilization program, which is estimated to cost \$8.6 million in this fiscal year. We have approved \$27 million for improved benefits to welfare families and GAINS beneficiaries, \$12 million to meet salary settlements for the O.P.P. and \$8 million for increased interest charges on the public debt. Ontario will improve its pension benefits for retired civil servants and teachers to the extent of \$17 million this fiscal year.

Mr. Speaker, the expenditure measures I have outlined will increase our 1975-76 Estimates by a total of \$150 million. Let me now turn to the revenue side. I am proposing additional tax cuts totalling \$28 million in 1975-76.

Eliminate Retail Sales Tax on Cars

The two softest spots in the Ontario economy are housing and automobiles. I have already outlined our measures to assist housing. Let me now outline a major action by the Ontario Government to increase jobs and activity in this key sector which directly employs 100,000 workers in this province. Effective immediately, I propose to remove the retail sales tax on new car registrations. This tax cut, which will remain in force until December 31, 1975, will be delivered in the form of a cash rebate from the Ministry of Revenue to the car purchaser. It will apply to all passenger cars and stationwagons built in Canada or the United States including 1975 models in inventory as well as new 1976 models, but excluding large luxury cars.

This measure will save purchasers an average of \$175 on the purchase of a new automobile. This will stimulate sales and increase production and jobs in this important industry. Expansionary benefits will spread throughout the economy. I estimate that this measure will cost some \$24 million in the current year.

Price Reduction on Wine

The June 23rd federal budget reduced excise taxes on imported and domestic wines. The Liquor Control Board of Ontario will apply its mark-up structure on this reduced base. I estimate the loss in revenue to Ontario will amount to \$4 million in 1975-76.

Sum Up

Mr. Speaker, the supplementary tax and expenditure actions I have outlined amount to \$178 million in 1975-76. The new housing initiatives, however, will involve large spending commitments in subsequent fiscal years. This makes it imperative that we finance these new initiatives without adding to our original expenditure total, or locking the Province onto a higher spending plateau. To achieve this goal, I propose internal cuts and hard-nosed reductions within existing programs.

SUMMARY OF EXPANSIONARY INITIATIVES	
	<u>Cost in 1975-76</u> (\$ millions)
Additional Support to Housing	42.0
Other Spending Initiatives	108.0
New Tax Cuts	28.0
Total	+178.0

EXPENDITURE CONSTRAINT

Let me reaffirm a basic conviction which I stated in my April budget.

"I am convinced that one of the root causes of the current inflation problem in Canada is excessive government spending and unnecessary growth in the size and complexity of the public sector. This has shifted an increasing share of our total resources out of private production uses in the economy, and has eroded the taxpayer's hard-earned income."

My 1975 budget has reflected this concern. It has continued Ontario's tough measures to curb the growth of government. I remind Members of our 2.5 per cent cut in civil service complement and our restraint in spending in order to set an example of responsible leadership.

Now we must take even tougher measures,

We were determined to find within our original spending Estimates sufficient savings to finance the \$178 million in new measures. We shall achieve these savings without sacrificing the delivery of essential services, without defaulting on our commitments to local governments and without distorting our priorities.

We have drawn up a two-part plan to achieve these expenditure cuts and internal efficiencies.

Program Cuts and Postponements

However worthy any existing program, there is scope within a total expenditure of \$11 billion to delete or postpone. We have isolated some \$96 million in savings which can be secured this fiscal year. We intend to scale down our land purchases by \$35 million, including purchases for the Parkway Belt, for future highway rights-of-way and for the acquisition of park land. Ontario Development Corporation loans will be reduced by \$7.5 million. We are postponing \$11 million of regional priority spending. We are stretching out capital projects under the Health Resources Development Fund for a saving of \$12 million this year. The start-up loan to the Algonquin Park Authority will be reduced by \$4.5 million. We shall proceed less ambitiously on the industrial parks program for a saving of \$4.9 million. The balance of \$21.2 million is made up of smaller savings spread throughout the Estimates of the Ministries.

Internal Cost Cutting

The second element of our restraint program focuses on internal government costs. Government administration is a labour-intensive activity which has become increasingly complex, sophisticated and costly. It is in this area that we must achieve the maximum reductions.

Management Board has been instructed to implement eight cost control measures which will produce savings of some \$82 million in 1975-76.

1. Immediate freeze on replacement staffing for all internal administrative functions such as information services, systems, planning, records, personnel, accounts and finance. With normal attrition, this should result in 1,500 fewer personnel in these areas by the end of the fiscal year.
2. Immediate moratorium on new or renewed contracts for management consulting and organizational planning.
3. A 10 per cent reduction in data processing budgets.

4. A 10 per cent reduction in direct operating expenditures (other than salaries and benefits but excluding institutions). This will reduce spending on travel, communications, supplies, services, furniture and equipment.
5. Reduction in internal planning and design operations which support programs whose real growth has levelled off or declined.
6. Reduction in inventories of supplies and equipment and improved inventory management.
7. Consolidation and rationalization of regional offices.
8. Review of research, statistical, planning, internal services and administrative units with the objective of reducing the number and size of such units, while improving effectiveness.

These control measures will be painful during the process of "dieting and sweating-down", but will produce a leaner and stronger provincial public service. Mr. Speaker, all Ministries will join in a concerted effort to assist Management Board in this 8-part economy drive.

In summary, program cuts of \$96.1 million and internal cost cuts of \$81.9 million, will produce total reductions of \$178 million in this fiscal year. These savings will finance the expansionary measures needed to reinforce economic recovery and to offset the effects of the federal budget.

SUMMARY OF EXPENDITURE CONSTRAINTS	
	<u>Savings in 1975-76</u>
	(\$ millions)
Program Cuts and Cash Flow Recoveries	96.1
Internal Cost Cutting	81.9
Total	178.0

Restraint by Other
Governments and Agencies

Before leaving this matter of cost control in government, let me say unequivocally that Ontario expects parallel economy actions on the part of all Provincial boards, agencies and commissions as well as local governments and their agencies that spend public money. On April 7, I urged local governments - both school boards and municipalities - to reduce their staffing, overhead and administrative spending and to defer less essential capital projects. I am pleased to inform Members that municipalities have cooperated with the Ontario Municipal Board and managed to strip out \$50 million in capital spending intentions for this year. I now ask the local sector to trim their operating budgets. Each one per cent trimmed saves \$50 million. I am confident that cuts can be made. By curbing the internal cost of local government in this way, ratepayers will be reassured that they are getting maximum services for their tax dollar.

Under the Edmonton commitment, Ontario has committed the maximum resources to school boards and municipalities that it can afford. Although the Province is reducing its complement, I cannot help but notice that local governments are expanding their internal bureaucracies. Unless local government staffing and spending is severely constrained, therefore, the increased financing burden must fall on local ratepayers. Stringent cost cutting and self discipline can prevent this otherwise inevitable increase in property taxes on our citizens.

Ontario Hydro

Spending restraint will only become truly effective when it becomes contagious. Accordingly, we expect that Hydro, like other government agencies, will prune its operating and capital budgets. On the operating side we expect that Hydro will work to achieve a comparable 10 per cent administrative cut. On the capital side, a minimum of \$1 billion must be shaved from Hydro's long-run investment program. This may mean stretching out for two or three years the completion schedule on the four major generating stations included in Hydro's planned expansion to 1985. I recognize that to some people this implies narrowing our customary margin of reserve capacity. Nevertheless, in the long run, Hydro's customers

will benefit from the improved cost structure that should result from the public enquiry now being conducted by the Ontario Energy Board.

Before concluding, let me say a few words about the rate hearing. First, I am appalled at the 29 per cent rate increase proposed by Hydro. Second, let me reaffirm what the Minister of Energy has repeatedly said - there will not be any increase in Hydro rates before January 1, 1976. Under the hearing process we have established, there cannot be any increase until the costs, revenues and capital expenditure programs of Ontario Hydro have been exposed to full public scrutiny. Following the economies we have discussed, I am hopeful that Hydro will succeed in moderating its expectations in the Energy Board application.

Federal Government Spending

Mr. Speaker, we are introducing these further economies in the operations of the Government of Ontario against the stark background of the extravagance and waste of the Government of Canada. While professing restraint, the federal government's June budget still adds 10,000 civil servants to its already bloated bureaucracy. While professing economy, the Government of Canada has reneged on shared-cost programs with the provinces, but left untouched its own fat operations. Paralleling Ontario's actions would have:

1. Reduced the federal complement by 2.5% rather than increasing it by 3.1%. This would have saved the taxpayers of Canada over \$270 million in payroll costs in 1975-76.
2. Cut other direct federal operating costs by 10 per cent which would have saved a further \$300 million.
3. Resulted in freezing consulting contracts which would generate further savings for the Canadian taxpayer of some half a billion dollars.

In short, the federal government could squeeze \$1 billion off its own internal costs with little impact on its programs or services. Such real, rather than illusory restraint would have avoided completely the need for tax increases on gasoline and in unemployment insurance.

I cannot resist one further observation. How many additional National Revenue staff will it take to administer Ottawa's 10¢ excise tax, with its incredible uneven applications, rebates, forms and complexity? I estimate that more than 1,000 civil servants will be required at a cost of tens of millions of dollars. And private sector costs will be even greater. Surely, this tops the list of absurd federal policies, at great cost to Canadian taxpayers.

CONCLUSION

My revised fiscal plan for 1975-76 provides for the financing of the new tax and expenditure initiatives within the April budget expenditure base. These expansionary and employment generating measures will cost \$178 million in this fiscal year. The required funding will be made possible by program cuts, postponements and internal cost cutting.

IMPACT OF SUPPLEMENTARY ACTIONS	
	<u>(\$ Million)</u>
Expenditure Initiatives	+150
Tax Cuts	<u>+ 28</u>
	+178
Program cuts and cash flow recoveries	- 96
Internal cost cutting measures	<u>- 82</u>
	-178
Impact on net cash requirements	<u>0</u>

The supplementary actions which I have tabled in this Statement will not impose any additional financing requirements in this fiscal year. The impact of the federal budget means that our revenues will decrease by \$100 million, of which \$60 million is attributable to reduced profitability of our corporations. The revenue loss will raise our overall cash requirements by \$100 million to a revised level of \$1,769 million. This higher figure is prudently within the Province's fiscal capacity and requires no significant change at this time in our financing strategy.

Our internal pension funds will generate \$1,152 million this year, leaving a balance of \$617 million to be financed from liquid reserves

and borrowing in the public market. We expect to re-enter the Treasury Bill market later this month. For the information of Members, our first Canadian issue in July was well received. The people of Ontario continue to benefit from this Province's pre-eminent credit rating which is founded on basic fiscal integrity.

REVISED 1975-76 FINANCIAL PLAN (\$ Million)		
	Budget Estimate	After Supplementary Actions
Budgetary Revenue	8,977	8,849
Budgetary Expenditure	10,192	10,142
Budgetary Deficit	1,215	1,293
Non-Budgetary Deficit	454	476
Net Cash Requirements	1,669	1,769
Method of Financing:		
Non-Public Borrowing (net)	1,125	1,152
Retirements	(31)	(31)
Public Borrowing to Date	-	150
Financing to be determined	575	498
Total Financing	1,669	1,769

Mr. Speaker, these supplementary actions are a positive and firm response to the economic situation and the vacuum in federal leadership and management of the economy. They will help to restore the public's confidence which was seriously damaged by the federal budget. We have placed before the Members a responsible answer to the federal budget on behalf of our people. We have done so in spite of the severe limitations on our resources. I am firmly convinced that more is needed. I am concerned by the diminishing capacity of provincial governments to continue stepping into the breach when Ottawa fails us. I urge the federal Minister of Finance to immediately convene a meeting with provincial Ministers of Finance.

APPENDIX

DETAILS OF RETAIL SALES TAX REBATE ON AUTOMOBILE PURCHASES

REBATE

- . Retail Sales Tax paid on purchases of certain automobiles registered on or after July 7, 1975 and before January 1, 1976 will be rebated to the purchaser.

TYPE ELIGIBLE

- . Automobiles eligible for rebates of sales tax are new passenger automobiles built in North America from parts manufactured in North America.

QUALIFICATIONS

- . Automobiles eligible for rebates are:
 1. Four-wheeled passenger vehicles having a seating capacity of not more than ten persons.
 2. All station wagons, either two or four wheel drive, manufactured in North America.

INELIGIBLE

- . Automobiles ineligible for rebates are:
 1. Those not manufactured in North America.
 2. Those automobiles manufactured in North America that are not station wagons and have engine displacements of 460 cubic inches or more.
 3. Vans and like vehicles, hearses, ambulances, trucks, buses, sport and other work vehicles, and all-terrain vehicles.
 4. Used cars.
 5. Automobiles acquired by lease or rental.

PAYMENT

- . New car dealers and purchasers will apply to the Ministry of Revenue, Retail Sales Tax Branch, on the prescribed form.
- . Enquiries should be directed to the District Retail Sales Tax Office nearest the dealer.

Supplementary Papers

Presented by the
Honourable W. Darcy McKeough
Treasurer of Ontario
for the information of the Legislative Assembly of Ontario

The Energy Factor and Ontario's Economic Recovery

- I Introduction**
- II Ontario's Economic Stabilization Program**
- III Impact of the June Federal Budget**
- IV The Revised Economic Outlook for Ontario**
- V Conclusion**

THE ENERGY FACTOR AND ONTARIO'S ECONOMIC RECOVERY

I INTRODUCTION

This paper summarizes the impact of the June federal budget on the prospects for Ontario's economic recovery in 1975. It documents how the success of Ontario's short-term stabilization program outlined in the April 1975 Ontario Budget will be seriously jeopardized by implementation of the contractionary measures of the June federal budget. The further increase in energy prices proposed in the federal budget will reduce Ontario's real economic growth in 1975 to 0.3 per cent, sustain current high levels of unemployment into 1976, accelerate inflation and retard the rate of economic recovery for the next twelve to eighteen months.

The following section of this paper reviews Ontario's 1975 economic stabilization program, outlines the considerations which influenced its development and indicates the implications of the worse than expected performance during the first quarter of 1975. The next section documents the contractionary impact of the June federal budget and presents in detail the implications of the energy price increases for individuals, and the performance of the Ontario economy. It also demonstrates the apportionment of the extra revenue from the proposed oil and natural gas price increases among governments and oil producers. The final section presents the revised economic forecast for Ontario.

II ONTARIO'S ECONOMIC STABILIZATION PROGRAM

The economic stabilization program presented in the 1975 Ontario Budget has provided immediate and short term stimulus in Ontario within the deteriorating economic environment in Canada and abroad. Among the key considerations in formulating the Budget strategy were the following important economic indicators.

- . The expectation that the U.S. economy would experience its second successive annual decline in real Gross National Product. This decline was forecast at 3.1 per cent by the President's Council of Economic Advisors. Other estimates predicted a greater decline.
- . Economic decline, or much reduced growth in Gross National Product was forecast for all other major industrial economies of the OECD.
- . Weakening foreign demand and escalating costs were expected to depress Canadian exports, particularly for automobiles and automotive parts.
- . Forecasts of economic growth for Canada in 1975, developed prior to the Ontario Budget, indicated that real growth would not exceed 2.6 per cent, compared to the 4 per cent gain projected in the November 1974 federal budget.
- . Ontario unemployment during January and February was already in excess of levels reached at any time during the 1970-1971 economic recession and Ontario's Gross Provincial Product in the first quarter of 1975 was expected to remain flat.

However, despite the deteriorating economic outlook for Ontario, elements of underlying strength were present. Sustained gains in personal disposable income, re-inforced by tax cuts in 1974 and further cuts in 1975, and the expectation of continuing investment strength particularly through increases in the utilities sector, were positive forces in Ontario's immediate economic prospects.

Ontario's short-term economic stabilization program, presented in the 1975 Ontario Budget was aimed at strengthening and reinforcing stabilization actions by senior levels of government in Canada and the United States. The prerequisite to successful accomplishment of Ontario's goals included:

- . a turnaround of the United States economy during the second half of 1975;
- . expansionary fiscal and monetary policy by the Canadian federal government; and
- . stable energy prices during 1975.

A budget plan based on the expectation that these conditions would be fulfilled in the course of 1975 seemed a reasonable one during the deliberations which led to the 1975 Ontario Budget. The tax cuts to prime the U.S. economy were bigger than first proposed by President Ford. The Ontario assessment of the fiscal policy of the November 1974 federal budget was that it was more appropriately directed than federal actions in the recession of 1970-1971 and was expected to be moderately expansionary. The retardation which higher energy prices would give to Canada's economic recovery and the further erosion of Canada's international competitive position which would follow increased energy costs, were considerations which pointed to the wisdom of an increase in energy prices no sooner than early 1976, when the Canadian economy had approached more normal levels of activity.

Against this assessment of the economic environment and actions by other levels of government, Ontario's short-term economic stabilization program was designed to be:

- . immediate and temporary in its effects;
- . focused on sectors most needing stimulus; and
- . directed at the expansion of the basic productive capacity required for future non-inflationary growth.

The expansionary thrust of Ontario's fiscal strategy was aimed at increasing the purchasing power of the private sector rather than providing further stimulus through increased government expenditure. Thus, while expenditure growth by the Ontario Government was firmly restrained, Ontario budgetary actions were directed to reinforce consumer incomes and purchasing power, encourage home ownership and the expansion of housing supply, increase investment and productivity and strengthen small business and farming.

The stimulative measures of the Ontario Budget included:

- . a temporary cut in the Retail Sales Tax from 7 per cent to 5 per cent in effect until December 31, 1975;
- . an increase in the guaranteed income of Ontario's lowest income elderly citizens to \$240 a month per person and \$480 a month per married couple;
- . extended free drugs to all pensioners;
- . dropping of 450,000 of Ontario's lowest income individuals from the personal income tax rolls;
- . encouragement to home ownership through the \$1,500 grant for first home buyers and other greatly expanded programs to increase housing supply;
- . encouragement for increased investment and productivity through full exemption from the Retail Sales Tax on all purchases of machinery and equipment purchased before January 1, 1977 and delivered before December 31, 1977 as well as paralleling the federal extension of the fast write-off of machinery and equipment used for manufacturing and processing for the three-year period January 1, 1975 to December 31, 1977; and
- . strengthening of small business and farming through a doubling of the maximum Small Business Tax Credit from \$3,000 to \$6,000 annually and funding for measures to supplement where necessary the federal Agricultural Products Stabilization Act.

During the previous recession, in 1970-1971, Ontario took a major expansionary role. In 1975, Ontario's fiscal impact is somewhat less expansionary than during the earlier period. However, at that time, the net fiscal impact of Ontario's budgetary policy was in excess of

the inadequate measures adopted by the federal government for the country as a whole. In developing Ontario's 1975 fiscal strategy, it was assumed that during the current recession the federal government would sustain a more appropriately directed fiscal thrust throughout the recovery period.

Developments Since the 1975 Ontario Budget

Ontario's economic recovery program indicated the possibility of real economic growth in Ontario of 2.5 per cent during 1975 through implementation of Ontario's short-term stabilization program, the realization of recovery in the U.S. and appropriate policy actions by the federal government including stable energy prices.

Prospects for Canadian 1975 economic performance showed further signs of deterioration in the weeks between presentation of the April 1975 Ontario Budget and the June federal budget.

- . First quarter performance for the U.S. showed a decline in real GNP of 11.3 per cent in annual terms and revised forecasts for U.S. economic recovery indicated a slower turnaround than initially expected and a real decline of GNP for the year of 4 per cent or more.
- . First quarter performance for Canada showed a decline in real GNP of 5.8 per cent in annual terms. Deteriorating exports and the continued slowdown in inventory accumulation were among the major factors dragging the Canadian economy below the level of GNP achieved in the fourth quarter of 1974.

The drop in first quarter performance, more severe for Ontario than Canada as a whole, was primarily due to the drop in automobile production and housing starts. Revised to reflect first quarter deterioration, realization of Ontario's projected path of economic recovery for the balance of the year implied a gain in real GNP of one per cent in 1975.

The June federal budget is outlined in the following section along with a detailed review of the impact of energy prices in retarding the recovery of the Ontario economy.

III IMPACT OF THE JUNE FEDERAL BUDGET

The June 1975 federal budget signalled a major switch in the fiscal strategy of the federal government significantly reducing the thrust of the November federal budget program.

The contractionary actions of the federal budget include:¹

- a special excise tax of 10 cents per gallon of gasoline for personal use with an exemption for industrial and commercial users through rebates;
- an increase in the well head price of oil by \$1.50 per barrel as of July 1;
- an increase in the City Gate (Toronto) price of natural gas to \$1.25 per mcf from 82 cents per mcf;
- an increase in the UIC premium effective early 1976; and
- a reduction in the maximum personal income tax cut allowed from \$750 to \$500.

Total federal cash requirements for 1975-1976 have been increased by \$2.3 billion since the November 1974 federal budget, due primarily to a fall off in expected revenues. The fiscal stimulus provided by this increase is fully eroded, however, by the depressing impact of higher petroleum prices on production costs and the effective reduction in real personal income.

The following section details the impact of the June federal budget on the economic prospects for Ontario for the balance of 1975 and 1976.

Impact of Federal Energy Measures

The 1975 Ontario Budget carefully reviewed the impact of the 1974 oil and gas price increases on the Ontario economy. It showed that in

1. Hon. John Turner, Budget Statement (Ottawa: Department of Finance, June 1975.)

1974 these price increases, which amounted to \$740 million, had already retarded economic performance, in terms of jobs, prices and output. It also demonstrated that in 1975 these increases would reduce employment by 38,000 jobs, add a further 2.1 per cent to consumer price increases and reduce real output by \$450 million.² Given these persistent and substantial contractionary forces, the Ontario Government strongly opposed additional increases in the price of crude oil and natural gas until the economy had returned to normal growth.³

The impact of the previous increases has not been fully digested, yet the federal policies of the June budget indicate an additional annual drain from the Ontario economy of \$740 million. The effects on Ontario of both the 1974 and 1975 price increases will result in Ontario consumers paying almost \$1.5 billion more for their energy needs in a full year.

ANNUAL COST TO ONTARIO OF FEDERAL
ENERGY POLICIES (\$ millions)

	1974 Price and Tax Increases	1975 Price and Tax Increases	Total
Crude Oil	560	300	860
Natural Gas	180	300	480
Excise Tax	-	140	140
Total	740	740	1,480

Source: Ontario Treasury estimate.

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2. Hon. W. Darcy McKeough, "Ontario's Economic Recovery", 1975 Ontario Budget (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1975). See also "Economic Impact on Ontario of 1975 Oil and Gas Price Increases", tabled at the Federal-Provincial Conference of First Ministers, April 9-10, 1975, Ottawa (Ontario Staff Paper).
 3. See Statement by the Hon. William G. Davis to the Federal-Provincial Conference of First Ministers, Ottawa, April 9, 1975.

These price increases will bear directly on consumers through higher fuel costs and indirectly through additional costs for other goods as fuel price hikes are passed through the service and goods producing sectors of the economy. The following table shows the impact on consumers of higher fuel costs alone over a full year.

ENERGY PRICE INCREASES AND THE ONTARIO CONSUMER (ONE YEAR IMPACT)			
	1974 Tax and Price Increases	1975 Tax and Price Increases	Total
Family heating with oil and driving 10,000 miles per year	\$151	\$126	\$277
Family heating and cooking with gas and driving 10,000 miles per year	\$124	\$148	\$272

The drag on Ontario's economic recovery represented by these moves is illustrated in the following table.

ESTIMATED MACRO ECONOMIC IMPACT OF JUNE
BUDGET ENERGY PRICE INCREASES (ANNUAL BASIS)

Inflation - C.P.I.

. Excise Tax adds	0.3%
. Oil Price Increase adds	1.2%
. Gas Price Increase adds	0.8%
TOTAL	<u>2.3%</u>

Employment Losses - Ontario

. Oil Price Increase	11,000
. Gas Price Increase	8,700
TOTAL LOSSES	<u>19,700</u>

Real G.P.P. Growth - Loss in Ontario

. Oil Price Increase	0.4%
. Gas Price Increase	0.3%
TOTAL Drop in Growth Rate	<u>0.7%</u>

With respect to the 1974 price increase, the April 1975
Ontario Budget pointed out that:

"Almost all of the \$2.70 price increase flowed into government coffers. The tax and royalty structure now in place leaves Canadian companies at a competitive handicap in terms of their ability to finance the exploration and development necessary to expand Canada's energy reserves. This clearly indicates the need to reduce the royalty/tax burden so that companies have adequate cash flow to finance the exploration and development necessary to expand Canada's energy base."⁴

The tax measures proposed in the June budget combined with announced changes in the Alberta royalty structure will provide, at best, modest additional financing for exploration and development.

4. Hon. W. Darcy McKeough, "Ontario's Economic Recovery", op. cit.

However, the end result of the 1975 energy price and tax measures, like those of last year, will be to generate huge new revenues to Ottawa and the producing provinces, and only marginal incentives to energy producers. In addition, the federal government takes all of the \$350 million in revenue from the 10 cents per gallon excise tax. The equivalent per barrel cost of petroleum in Canada for personal use with the addition of this excise tax exceeds \$11.00, the current spot world rate.

DISTRIBUTION OF REVENUE FROM JULY 1, 1975 CRUDE
OIL PRICE INCREASE OF \$1.50 PER BBL.

	Apportionment of Price Increase	Per Cent of Increase
To Federal Government	.36	24
To Alberta	.77	51
To Oil Producers	<u>.37</u>	<u>25</u>
Total	\$1.50	100

Total cash flow to oil producers is increased by 37 cents per barrel in Alberta to \$2.63. This cash flow to companies will be inadequate to encourage further exploration for new resources. Furthermore, the proposed 25 per cent allowance tax measure used to deliver extra cash to the companies is inappropriate. Direct and increased write-offs for exploration and development would have ensured continued exploration. Under the proposed system the added company income may be spent in less advantageous ways.

The increase in the field price of natural gas from 45 cents per mcf to 88 cents per mcf will be distributed as follows:⁵

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5. Assumes no part of the increase in Toronto City gas price from 82¢ mcf to \$1.25 mcf will be applied to higher transmission costs.

DISTRIBUTION OF NEW REVENUES FROM NATURAL
GAS PRICE INCREASE (new natural gas only)

	Apportionment of Price Increase	Per Cent of Increase
To Federal Government	.11	26
To Alberta	.18	42
To Gas Producers	.14	32
Total	\$.43	100

Note: No consideration of flow back from the export tax is made in the estimates.

Clearly, the distribution of the increased revenues from new natural gas is a better model than for crude oil and a further reduction is called for in the Alberta royalty rate on oil to achieve correspondingly equitable shares.

At 82 cents per mcf on January 1, 1975 the natural gas price in Ontario already was 14 cents per mcf higher than the average price in neighbouring American states. Ontario users now face the prospect of a substantial increase of 43 cents per mcf to \$1.25 this year. The neighbouring U.S. markets will also have increases this year, however, the gap is widening which makes the comparative cost greater and will further erode our export opportunities.

COMPARISON OF CITY GATE PRICES FOR NATURAL GAS
ONTARIO VERSUS NORTHEASTERN U.S.

	At January 1, 1975 (cents/mcf)	Estimated At November 1, 1975 (cents/mcf)
Ohio	73	85
Pennsylvania	82	93
Michigan	70	105
Illinois	63	75
New York	<u>71</u>	<u>100</u>
Weighted Average U.S.	68	90
Ontario (Toronto)	82	125

Note: Michigan price highest due to higher price for Canadian natural gas
which represents 15 per cent of supply.

The following table shows the overall distribution of revenues from oil and gas on an annual basis.

DISTRIBUTION OF OIL AND NATURAL GAS REVENUES
FOR THE 1974 AND 1975 PRICE AND TAX CHANGES

	<u>\$6.50 OIL</u>		<u>\$8.00 OIL</u>	
	(\$ per bbl)	(\$ million)	(\$ per bbl)	(\$ million)
Operating Cost	.60		.60	
Federal Tax	1.04	598	1.40	805
Alberta Royalties				
and Tax	2.60	1,495	3.37	1,938
Company Cash Flow	2.26	1,300	2.63	1,512
Well Head Price/TOTAL	\$6.50	\$3,393	\$8.00	\$4,255

	<u>45¢ per mcf</u>		<u>88¢ per mcf</u>	
	<u>NATURAL GAS</u>		<u>NATURAL GAS</u>	
	(\$ per mcf)	(\$ million)	(\$ per mcf)	(\$ million)
Operating Cost	.08		.08	
Federal Tax	.07	140	.18	360
Alberta Royalties				
and Tax	.13	260	.31	620
Company Cash Flow	.17	340	.31	620
Field Price/TOTAL	.45	740	.88	1,600

Notes: 1. Oil and gas based on Alberta production of 575 million bbl and 2 trillion cf annually.

2. Includes revisions to Alberta royalty structure to 50% above \$6.50.

Within the existing royalty/tax regime, governments are taking the bulk of well head revenues. Since 1974 the federal share of oil revenues will have increased eightfold to \$800 million by 1976. Alberta's share will have increased fourfold. By contrast, the companies' share will

increase only 25 per cent. With natural gas, however, the companies' share of the increased revenues is much more equitable.

In summary, the federal budget is contractionary in its macro economic impact. It ensures new and higher energy costs to consumers and contributes to a deterioration in the prospects for economic recovery.

IV THE REVISED ECONOMIC OUTLOOK FOR ONTARIO

Ontario's projected recovery path, revised for poor first quarter performance in Canada and the U.S., indicated potential real GPP growth of one per cent in 1975. Against this altered economic outlook, an appropriately directed counter cyclical June federal budget would have been expansionary, aimed to move the growth of the economy back towards the one per cent potential.

The fiscal strategy of the June federal budget was contractionary. The effect of the federal budget is to reduce Ontario's forecast GPP growth to about 0.3 per cent, a fall off of 0.7 per cent from the potential recovery path.

The June federal budget also:

- . increases the annual level of unemployment from 5.6 per cent to 6.1 per cent;
- . reduces third quarter growth from an expected rate of 2.5 per cent to a possible 1.8 per cent and reduces fourth quarter growth from 3.1 per cent to 2.0 per cent; and,
- . adds substantially to the annual level of inflation which had begun to moderate prior to the measures of the federal budget.

Ontario's projected path of economic recovery is shown in the following tables. These illustrate the economic recovery path for Ontario presented in the 1975 Ontario Budget, using the revised national accounts data. In the Budget, performance was expected to be flat in the first quarter, increase by one per cent in the second, and grow at 2.5 per cent and 3.1 per cent in the third and fourth, for a 2.5 per cent real gain in GPP during the year. The federal budget reduces this growth in GPP to 0.3 per cent.

PROJECTED PATH OF ECONOMIC RECOVERY IN ONTARIO
IN 1975 AND THE FIRST HALF OF 1976

(Quarter-to-Quarter Change) Per Cent

		<u>1975 Ontario Budget</u>	<u>Federal Budget</u>
1975	I	0	-1.5
	II	1.0	.9
	III	2.5	1.8
	IV	3.1	2.0
Year-Over-Year		2.5	.3
1976	I		1.5
	II		1.8

Source: Revised National Accounts data and Ontario Treasury estimates.

Notes: 1. 1975 Ontario Budget estimates revised to reflect National Accounts revisions for 1974.

2. Federal budget estimates reflect indicated federal implementation of federal budget measures.

In 1976, Ontario's economic growth will be further retarded as increased natural gas prices come into effect late in 1975 and the other federal measures continue to work through the economy. Unemployment will remain at unacceptably high levels and price increases consequent upon higher energy costs will be at a rate only modestly below those expected in 1975.

UNEMPLOYMENT IN ONTARIO
IN 1975 AND THE FIRST HALF OF 1976

(Seasonally Adjusted) Per Cent

		<u>1975 Ontario Budget</u>	<u>Federal Budget</u>
1975	I	5.9	5.9
	II	6.0	6.3
	III	5.0	6.1
	IV	4.6	6.0
Annual Average		5.4	6.1
1976	I		6.0
	II		5.8

Source: Statistics Canada and Ontario Treasury estimates.

Under the 1975 Ontario Budget plan, unemployment was expected to average 5.4 per cent. With first quarter revision and the modified outlook for the U.S., this increases to 5.6 per cent unemployment. The impact of the federal budget will add 0.5 per cent to annual unemployment, equivalent to about 19,000 jobs.

CONSUMER PRICE INDEX

Annual Rates of Change Per Cent

1975 Ontario Budget	9.5
June Federal Budget	9.9

V CONCLUSION

This paper has documented the impact of the June federal budget in retarding Ontario's 1975 economic recovery. It has outlined the impact of the proposed energy price increases on individuals, resource companies and governments. It has demonstrated that the contractionary shift in federal fiscal policy from the plan outlined in the November federal budget will reduce Ontario's real economic growth in 1975 to 0.3 per cent. The paper has demonstrated the extent to which the June federal budget undermined the strong recovery actions initiated by Ontario in April.

Ontario's Experience Under Cost-Sharing

I Introduction

II The Shared-Cost Experience

- General Evaluation
- Medicare
- Hospital Insurance
- Extended Care

III The Opting Out Alternative

IV The Ontario Offer

V Conclusion

ONTARIO'S EXPERIENCE UNDER COST SHARING

I INTRODUCTION

During the post-war period, great pressures arose for services in the areas of health, education and welfare. Although these matters fell within provincial jurisdiction, provincial governments did not have an adequate share of the country's financial resources to meet the demands placed upon them. To bridge this fiscal gap, and to meet its own objectives of ensuring national standards in major social undertakings, the federal government moved in a large way into the creation of shared-cost programs. The first major program of an on-going nature was the Hospital Insurance and Diagnostic Services Agreement of 1957.

Since the early 1960's, there has been a rapid proliferation of shared-cost programs. For example, in 1975-76, there are over 65 shared-cost programs operating in Ontario, with total recoveries from the federal government amounting to about \$1.8 billion, or roughly 20 per cent of the Province's total revenue.¹ Most of these programs are very small in nature, with only four delivering sums in excess of \$50 million each:

- . Hospital Insurance
- . Canada Assistance Plan
- . Medical Care
- . Post-Secondary Education

These four programs account for 90 per cent of the total amount Ontario receives in federal conditional grants.

It is the purpose of this paper to review in detail the experience Ontario has had with the shared-cost arrangements and to document the case that has been made in favour of an alternative financing mechanism, namely, opting out.

1. These figures exclude the tax-transfer portion of the federal assistance provided to post-secondary education.

II THE SHARED-COST EXPERIENCE

General Evaluation

The problems with the shared-cost programs have been extensively examined.² The following list is meant to be illustrative, not an exhaustive inventory of the difficulties that arise.

- Provincial priorities are distorted by the availability of federal dollars. The classic example of this, discussed below, was Medicare. Massive financial leverage by the federal government forced Ontario to join this program even though the Province already had a perfectly satisfactory system of medical insurance.
- Capricious changes in policy by the federal government leave the provinces stranded to carry the burden of programs that were often imposed upon them in the first place. An example of this was the abrupt withdrawal of assistance to technical and vocational education in 1967.
- Unilateral imposition of arbitrary ceilings on the rate of growth of federal contributions to established programs is unreasonable. It leaves provinces with an undue financial burden, and also creates great inequities because of the differential levels of service provided in different jurisdictions. Classic examples are the existing ceiling on post-secondary education and the ceilings on Medicare introduced in the recent federal budget.
- Provincial administrative structures are interfered with. One famous case concerned the offer of federal funds for the care of juvenile delinquents. In order to take advantage of this proposal, the Province would have had to switch a whole administrative unit from one department to another. Recent discussions have led to a mutually satisfactory arrangement, but potential sharing was lost for many years.

2. Hon. W. Darcy McKeough, Supplementary Papers on Federal-Provincial Finance (Ministry of Treasury, Economics and Intergovernmental Affairs, 1972) and Federal-Provincial Shared-Cost Programs in Ontario (Staff Paper, Ministry of Treasury, Economics and Intergovernmental Affairs, 1972).

- . Rigidly defined criteria for eligibility result in inequities, feuds and distortions.
- . Administrative costs are unnecessarily high.

This section of the paper elaborates on some of the above difficulties by considering three important case studies: Medicare, Hospital Insurance, and Extended Care.

The Case of Medicare

Following the passage by Parliament of the Medical Care Act in December 1966, a lengthy debate ensued between Ontario and the federal government. The Ontario Government argued that the federal Medicare package was ill-conceived and badly timed, and, in any event, unnecessary. The Province already had a satisfactory mixed system of medical insurance, with the public OMSIP system and private carriers covering over 95 per cent of the population. This system also accommodated low-income earners with generous premium assistance. As the Honourable Charles MacNaughton put it, "medicare is obviously of lower priority than housing or higher education"³.

Ontario also argued that the long-term costs of Medicare would be a lot higher than anticipated by the federal government. As Mr. MacNaughton said to the Federal-Provincial Meeting of Finance Ministers in November 1968,

The decision by Ottawa to force the introduction of medicare at a time when all governments know what the financial future is going to be seems to us, therefore, ill-considered and irresponsible.⁴

Pointing to Ottawa's own projections of rapidly rising costs, he posed the prescient question,

3. Statement by the Hon. Charles S. MacNaughton, Treasurer of Ontario and Minister of Economics, to the Federal-Provincial Meeting of Finance Ministers, Ottawa, November 4 & 5, 1968.

4. ibid.

What guarantee have we that, in a few years from now, the federal government will not dump the full responsibility for this program on the provinces, and close off or limit its contributions after it has obliged the provinces to embark on this slippery slope?⁵

It was against this background that the federal government chose to lever Ontario into Medicare against its own better judgment. In 1969, the federal government introduced a Social Development Tax in order to pay for its share of Medicare. This special levy extracted some \$225 million from Ontario taxpayers in its initial year. Ontario argued that its priorities simply did not suggest entering Medicare, and that, if it did not participate, these funds should be returned to the people of the province for more urgent uses. This position was flatly rejected. Commenting on the implications of this type of federal leverage, the Honourable John Robarts said,

We object very strenuously to the use of the federal spending power to really alter the Constitution ... Medicare is a glowing example (of this), a Machiavellian scheme ... one of the greatest political frauds that has been perpetrated on the people of this Country.⁶

Almost within a year, the Ontario case against Medicare was vindicated. The costs of the total health care system began to escalate much more rapidly than expected by the federal government, so that, by the spring of 1970, the President of the federal Treasury Board felt called upon to initiate discussions about expenditure ceilings. In a letter to Mr. MacNaughton, Mr. Drury stated that

5. Statement by the Hon. Charles S. MacNaughton, *op. cit.*
6. Statement by the Hon. John P. Robarts, Prime Minister of Ontario, at the Constitutional Conference, February 10-12, 1969.

... short run national targets should be set for the purpose of limiting the rate of growth of expenditures on hospital and medicare programs and higher education ... this necessarily implies the establishment by individual provincial governments of targets which would be realistic ...⁷

Shortly thereafter the federal government presented the first in a series of proposals that culminated with the so-called Lalonde-Turner formula of April 1973. The Ontario Government participated fully in the debate over this formula, but concluded, with all other provinces, that the federal package was financially unacceptable. Following the retraction of the Lalonde proposal last autumn, a task force was set up to examine means by which provinces could be encouraged to emphasize lower cost services.

Only six months after this task force was established the federal government abruptly announced, in its June 1975 budget, that it was going to impose arbitrary ceilings on the rate of growth of its Medicare contributions. With allowance for population growth, the ceilings are 14.5 per cent in 1976-77, 12 per cent in 1977-78, and 10 per cent in years thereafter. Ontario projects that its Medicare costs for the corresponding years will grow by 23 per cent, 21 per cent, and 19 per cent respectively. In dollar terms the federal ceilings are expected to cost Ontario over \$200 million in lost sharing before 1980.

By imposing these arbitrary ceilings, the federal government has failed to recognize the degree to which Ontario has successfully kept increases in doctors' fee schedules below settlements elsewhere in the economy. It has also failed to recognize that escalating costs are primarily due to increasing utilization rates, a phenomenon that resulted from the federal introduction of a public and universal program, and a phenomenon which is largely beyond the provinces' capacity to control.

7. The Hon. C. M. Drury to the Hon. Charles S. MacNaughton, May 15, 1970.

The record with Medicare is thus ample proof of the pitfalls of cost sharing. The story began with a massive leveraging action against the provinces and ended with an abrupt and unilateral federal retrenchment from a program that it imposed upon the provinces in the first place.

The Case of Hospital Insurance

When the Hospital Insurance and Diagnostic Services Act was introduced in 1957, it provided for sharing on a fairly wide base. Since that time, however, the provinces have introduced many new services which have been judged by Ottawa to be non-shareable. As stated in November 1973,

While components of the hospital and medical insurance programs are recognized by the federal government for cost-sharing purposes, a considerable range of other programs are financed entirely by the provinces ... It is significant to note that three of the provincial programs financed solely from provincial revenues are programs of long standing which are universally provided and form an integral part of each province's health system.⁸

In Ontario, these non-shared programs account for 23 per cent of the total health care package. The major non-shared programs, with their 1975-76 costs, are: Psychiatric Services (\$195 million), Nursing Home Care (\$123 million), Drug Benefits (\$35 million), insurance related to Optometry, Osteopathy, Podiatry, and Chiropractic (\$33 million), Ambulance Services (\$31 million), and Home Care (\$13 million).

The non-shareability of these programs was a key issue in the debate over the Lalonde formula. The federal government consistently took the position that it was only interested in "re-financing" Hospital Insurance and Medicare; it suggested that the non-shared programs would have to be dealt with separately and subsequently. The provinces, on the other hand, stated that an effective

8. Final Report, Committee on Health Priorities and their Relationship to Federal-Provincial Cost Sharing, November 1973.

strategy of expenditure constraint would require a more flexible approach to the sharing of non-shared programs. They recognized that at least some of the non-shared services have potential as lower cost alternatives to hospitalization; without sharing in these programs, provinces would continue to be levered into costly and intensive forms of care. The provincial position was thus an attempt to re-establish a federal presence in the entire health care system, and to make the reality of sharing consistent with the implicit intentions that the federal government announced back in 1957.

After the collapse of the Lalonde proposal, the federal government set up a task force, as indicated, to explore possibilities for achieving cost efficiencies in both Medicare and Hospital Insurance. The rigidity of the federal position again became clear when it was learned that the task force was instructed only to consider changes that could be made within the confines of the existing legislation; sharing for the non-shared programs was thus effectively excluded from consideration. The notice of termination given in the budget now implies that the federal government has itself lost faith in this project, and that it is probably contemplating ceilings on Hospital Insurance for 1980.

The record with the Hospital Insurance program is thus one replete with rigidities and confusions. Instead of discussing meaningful alternatives, the federal government has consistently shown a lack of imagination in dealing with the real problems of health care financing.

The Case of Extended Care

The issue of Extended Care exemplifies not only the rigidities in cost sharing, but also the lack of co-operation that is frequently made apparent by the federal authorities.

Ontario's Extended Care program was introduced in April 1972 to provide financial assistance to Ontario residents of nursing homes and homes for the aged who do not require hospital care but do require skilled nursing services and regular supervision by a physician. The program was deliberately structured in such a way that

it would qualify for sharing under the Canada Assistance Plan. The federal government accepted Ontario's claims, as submitted, for well over a year and a half.

Then, in an abrupt about-face, the federal authorities ruled that Extended Care was ineligible for sharing because it was a "universal" program. Mr. Lalonde and Mr. Trudeau both assured Ontario that a way would be found around the difficulty. In September 1973, the Prime Minister wrote to Premier Davis as follows,

Please be assured that (the) commitment made by Mr. Lalonde, of ensuring that no province will suffer an adverse loss of revenue under the Canada Assistance Plan because of their introducing universal programs, will be honoured by the federal government.⁹

After lengthy negotiations the federal government agreed to provide a 'replacement formula', and under this arrangement Extended Care is now shared. The point, however, is that the replacement formula went into effect as of January 1, 1974; it was not made retroactive to the date of the program's inception. Consequently, Ontario lost \$40 million in sharing, despite its best efforts to conform with program rules, and despite assurances from the Prime Minister himself that no losses would be sustained.

III THE OPTING OUT ALTERNATIVE

Given the above difficulties surrounding shared-cost programs, Ontario has come to favour a more rational system of funding, namely, that of opting out.

The concept of 'opting out' dates back to the mid-1960's, and was given credibility by the federal government's 1965 offer to let the provinces contract out of certain shared-cost programs in exchange for personal income tax points. By making this proposal, the federal government signalled its interest in solving the fiscal and constitutional problems created by the mature shared-cost programs.

9. The Rt. Hon. P. E. Trudeau to the Hon. W. G. Davis, Sept. 21, 1973

Only Quebec accepted the federal offer. The other provinces turned the proposal down for a variety of reasons, including uncertainty over the many financial changes contemplated for 1967. Prime Minister Robarts summed up the Ontario position when he said,

Before accepting any transfer of well-established shared-cost programs, Ontario wants to explore further the matters of tax sharing and equalization so that we can properly evaluate the whole package of financial arrangements available to us.¹⁰

Because of the incomplete acceptance of the federal offer, Quebec's opting out never matured into a meaningful fiscal redress or a complete provincial assumption of provincial responsibilities. Even after a decade, Quebec is in essentially the same position as all other provinces, the only difference being that it receives federal reimbursement in a different form.

By 1968, the federal government had changed its tactics and effectively withdrawn its opting out offer. By 1970, it had indicated that it would retain supervision over the programs, and that it would seek to establish targets for acceptable cost escalation. This was regarded by the provinces as a retrogressive step since it was a move away from what seemed like a mutually satisfactory line of advance.

The 1971 Ontario Budget reopened the question by asserting that there was sufficient evidence of federal retrenchment and arbitrariness in the shared-cost system to convince Ontario that full opting out was the only rational course. In order to gain the benefits of certainty, control, flexibility and freedom in its priority setting, Ontario decided that it was prepared to accept whatever risks might be involved in settling on fiscal equivalence. The 1971 Ontario Budget thus initiated a series of statements on the logic of opting out:

10. Statement by the Hon. John P. Robarts, Prime Minister of Ontario, to the Federal-Provincial Tax Structure Committee, September 14, 1966.

- April 1971 - This will eliminate complex bureaucratic procedures and leave each level of government the full responsibility to plan and finance its own programs within its own framework of priorities.¹¹
- November 1971 - The only legitimate federal role (remaining) in these established provincial programs is a financial one, and this should be rationalized through tax sharing.¹²
- April 1972 - The Ontario Government feels that the very complicated and cumbersome structure of shared-cost programs now in existence is no longer warranted to assure the maintenance of standards and objectives already reached. In fact, it is becoming obvious that the very existence of some major formula-oriented programs is an impediment to the further improvement of the services involved and the achievement of greater cost efficiencies.¹³
- May 1973 - The difficulties that I have mentioned are not specific to us, but are common to all provinces. Suffice it to say, opting out is the only logical and effective way to end these problems.¹⁴

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11. Hon. W. Darcy McKeough, Ontario Budget 1971 (Toronto: Ministry of Treasury and Economics, 1971).
 12. Hon. W. Darcy McKeough, The Reconstruction of Economic and Fiscal Policy in Canada, Meeting of Ministers of Finance, November 1-2, 1971.
 13. Hon. W. Darcy McKeough, Supplementary Papers on Federal-Provincial Finance, Ontario Budget 1972 (Ministry of Treasury, Economics and Intergovernmental Affairs, 1972).
 14. Hon. John White, Opting Out and Tax Sharing, Statement to the Meeting of Ministers of Finance, May 8, 1973.

The Ontario case was accompanied by concrete proposals concerning the fiscal equivalences that were deemed appropriate. At the Conference of Finance Ministers in 1972, Ontario put forward a plan for a fiscal transfer from the federal government of 21 per cent of the personal income tax field.¹⁵ Quebec subsequently made a proposal for the transfer of 28 PIT points, equalized to the level of the highest province. At the May 1973 Meeting of Finance Ministers, the Ontario Government again indicated the numbers it thought were appropriate as the basis for discussion.¹⁶ Nothing in the way of a positive response was received from Ottawa.

Rather than acknowledging this growing provincial preference for opting out, the federal government initiated proposals which would merely cut back its own financial commitment, and failed to come to grips with the many problems discussed in Section II of this paper. In frustration over its failure to win support for its general approach, the federal government has now come to the point of taking unilateral and arbitrary actions, such as those contained in its budget of June 1975.

IV THE ONTARIO OFFER

In reaction to the recent federal budget, the Government of Ontario offers to assume complete responsibility for all health care programs in exchange for 17 points of personal income tax.

As the following data indicate, this offer would leave the Province with a sizable risk, and would certainly not entail any "fiscal dividends" to assist in the financing of programs that are currently non-shared. The lack of a built-in safety margin for the Province will strengthen the Provincial resolve to economize. Complete Provincial control over the programs will also ensure that economies in staffing and delivery are accomplished within a framework of maximum provincial flexibility.

15. Hon. W. Darcy McKeough, Supplementary Papers, op. cit.

16. Hon. John White, Opting Out and Tax Sharing, op. cit.

FEDERAL REIMBURSEMENTS AND FISCAL EQUIVALENCE
(\$ million)

	<u>1972-73</u>	<u>1973-74</u>	<u>1974-75</u>	<u>1975-76</u>	<u>1976-77</u>
Hospital Insurance	476	533	652	778	913
Medicare	225	244	275	325	398
	701	777	927	1,103	1,311
Value of 1 Point of P.I.T.	40	47	56	65	75
Fiscal Equivalence (P.I.T. points)	17.5	16.5	16.5	17.0	17.5

The federal-provincial change in tax occupancy, of course, will have no direct bearing on the individual taxpayer. After transferring 17 points, almost 64 per cent of the personal income tax field will still remain with the federal government, a more than adequate occupancy to use this tax as a discretionary stabilization instrument. The federal-provincial tax realignment is illustrated in the following chart.

17-POINT HEALTH TRANSFER

	<u>P.I.T. Liability</u>		<u>Shares of Tax Field</u>	
	<u>Before Transfer</u>	<u>After Transfer</u>	<u>Before Transfer</u> (%)	<u>After Transfer</u> (%)
Federal	100.0	83.0	76.6	63.6
Ontario	30.5	47.5	23.4	36.4
	130.5	130.5	100.0	100.0
Total	130.5	130.5	100.0	100.0

V CONCLUSION

This paper has reviewed Ontario's experience with the shared-cost programs. It has highlighted the many difficulties encountered in the area of health sharing and has documented Ontario's strong and consistent preference for opting out. The arbitrary moves of the recent federal budget underscore once again that provincial governments require greater flexibility to contain costs and adjust to their own priorities. Ontario is prepared to opt out right now, accept all the financial risks, and assume complete responsibility in the area of health care.

Financial Statements

STATEMENT OF OPERATIONAL CASH
REQUIREMENTS AND RELATED FINANCING
(\$ million)

	1975-76 Original <u>Estimate</u>	1975-76 Revised <u>Estimate</u>	<u>Change</u>
<u>Budgetary Transactions</u>			
Revenue	8,977	8,849	(128)
Expenditure	<u>10,192</u>	<u>10,142</u>	<u>(50)</u>
Budgetary Deficit	1,215	1,293	78
<u>Non-Budgetary Transactions</u>			
Receipts and Credits	382	396	14
Disbursements and Charges	<u>836</u>	<u>872</u>	<u>36</u>
Non-Budgetary Deficit	454	476	22
NET CASH REQUIREMENTS	1,669	1,769	100
Non-Public Borrowing (Net)	1,125	1,152	27
Public Borrowing			
Debentures:			
Issues	-	150	150
Retirements	(31)	(31)	-
Financing to be determined	575	498	(77)
TOTAL FINANCING	1,669	1,769	100

Excludes all transactions relating to the issue, retirement and servicing of all debentures by the Province on behalf of Ontario Hydro.

BUDGETARY REVENUE
(\$ million)

	1975-76 Original <u>Estimate</u>	1975-76 Revised <u>Estimate</u>	<u>Change</u>
<u>Taxation</u>			
Personal Income Tax (Net)	1,694	1,679	(15)
Federal Revenue Guarantee	330	330	-
Corporation Taxes:			
Income Tax	877	817	(60)
Capital and Premium Taxes	160	160	-
Retail Sales Tax	1,343	1,314	(29)
Gasoline Tax	510	495	(15)
Motor Vehicle Fuel Tax	71	66	(5)
All Other Taxation	<u>409</u>	<u>409</u>	<u>-</u>
	5,394	5,270	(124)
<u>Other Revenue</u>			
Premiums - OHIP	564	564	-
LCBO Profits	355	351	(4)
Vehicle Registration Fees	209	209	-
Fees, Licences, and Other Revenue	<u>288</u>	<u>288</u>	<u>-</u>
	1,416	1,412	(4)
<u>Payments from the Federal Government</u>	1,808	1,808	-
<u>Interest on Investments</u>	359	359	-
 TOTAL BUDGETARY REVENUE	 8,977	 8,849	 (128)

BUDGETARY EXPENDITURE
(\$ million)

	1975-76 Original Estimate	1975-76 Revised Estimate	Change
Health	2,886	2,873	(13)
Education	1,710	1,722	12
Colleges and Universities	1,018	1,026	8
Community and Social Services	855	882	27
Culture and Recreation	122	116	(6)
Transportation and Communications	954	946	(8)
Natural Resources	211	205	(6)
Agriculture and Food	143	152	9
Environment	83	85	2
Industry and Tourism	43	44	1
Labour	19	19	-
Energy	3	3	-
Solicitor General	117	128	11
Correctional Services	117	119	2
Attorney General	96	97	1
Consumer and Commercial Relations	41	41	-
Treasury, Economics and Intergovernmental Affairs	429	425	(4)
Government Services	294	278	(16)
Revenue	168	168	-
Housing	181	181	-
Other	25	30	5
Public Debt - Interest	677	684	7
INTERNAL COST REDUCTIONS *	-	(82)	(82)
TOTAL BUDGETARY EXPENDITURE	10,192	10,142	(50)

* Details provided on following page.

REDUCTIONS IN INTERNAL
GOVERNMENT COSTS

	Estimated Savings in 1975-76 (\$ millions)
<u>Actions</u>	
1. One year freeze on new management consulting contracts, including renewals	10.0
2. 10% across-the-board cutback in direct operating expenditure other than salaries and benefits (e.g. travel, services, equipment and supplies)	44.4*
3. Immediate hiring freeze for internal administration functions to achieve an absolute reduction of 1,500 civil servants. (e.g. information, systems, personnel, accounts, finance and administration, planning, records management)	7.0**
4. Cut back selected internal support operations (e.g. design services, planning and development)	1.5
5. Reduction and improved management of inventories	10.0
6. Rationalize regional offices	***
7. Data processing budget reductions	2.5
8. Review and scale down certain branches and units within the Government	<u>6.5</u>
TOTAL	<u><u>81.9</u></u>

* excluding institutions

** \$20.0 million in full year.

*** savings will be realized in subsequent years.

DETAILS OF NON-BUDGETARY TRANSACTIONS
(\$ million)

	1975-76 Original <u>Estimate</u>	1975-76 Revised <u>Estimate</u>	<u>Change</u>
<u>Receipts and Credits</u>			
Repayments of Loans and Advances	167	171	4
Pension Funds, Deposit, Trust and Reserve Accounts	194	204	10
Province of Ontario Savings Deposits (Net)	21	21	-
TOTAL RECEIPTS AND CREDITS	382	396	14
<u>Disbursements and Charges</u>			
Loans and Advances:			
Ontario Mortgage Corporation	208	213	5
Ontario (and Student) Housing Corporations:			
Housing Action Program	28	28	-
Regular Programs	67	92	25
Water Treatment and Pollution Control Facilities	138	148	10
Education Capital Aid Corporation	92	92	-
Universities Capital Aid Corporation	42	42	-
Ontario Development Corporations	78	70	(8)
Transportation Development Corporation	-	6	6
Other	<u>99</u>	<u>95</u>	<u>(4)</u>
	752	786	34
Pension Funds, Deposit, Trust and Reserve Accounts	84	86	2
TOTAL DISBURSEMENTS AND CHARGES	836	872	36



